

***United States Court of Appeals
for the Second Circuit***



**PETITIONER'S
BRIEF**

62-5

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NO. 77-1547

BRADFORD NATIONAL CLEARING CORPORATION and
BRADFORD SECURITIES PROCESSING SERVICES, INC.,
Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

NATIONAL SECURITIES CLEARING CORPORATION

Intervenor in support
of Respondent

Petition For Review Of An Order Of The
Securities And Exchange Commission

BRIEF FOR PETITIONERS

BRADFORD NATIONAL CLEARING CORPORATION and
BRADFORD SECURITIES PROCESSING SERVICES, INC.

MORRIS N. SIMKIN
Attorney for Petitioners
1700 Broadway, 20th Floor
New York, New York 10019
(212) 581-5800

United States Court of Appeals
for the District of Columbia Circuit

FILED SEP 2 1977

GEORGE A. FISHER
CLERK

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

-----X
:
BRADFORD NATIONAL CLEARING CORPORATION
:
and BRADFORD SECURITIES PROCESSING
:
SERVICES, INC.,
:
:

Petitioners,

No. 77-1547

- against -

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

National Securities Clearing Corporation
Intervenor in Support of Respondent
:
:
-----X

CERTIFICATE REQUIRED BY RULE 8(c) OF
THE GENERAL RULES OF THE UNITED STATES
COURT OF APPEALS FOR THE DISTRICT OF
COLUMBIA CIRCUIT

The undersigned counsel of record for Petitioners, certifies
that the following listed parties submitted comments below:

Bradford National Clearing Corporation.....(for Petitioners)
Bradford Securities Processing Services, Inc....(for Petitioners)
TAD Depository Corporation.....(for Petitioners)

The following listed party has an interest in the outcome of
this case:

National Securities Clearing Corporation

The parent corporation of Petitioners is Bradford National Corporation. Its subsidiaries and affiliates are:

Bradford Administrative Services, Inc.
Bradford Data Services, Inc.
Bradford Financial Processing Services, Inc.
Bradford National Clearing Corporation
Bradford National Computer Services, Inc.
Bradford National Corporate Services, Inc.
Bradford Securities Operations, Inc.
Bradford Securities Processing Services, Inc.
Bradford Services, Inc.
Bradford Trust Company
Bradford Trust Company of Boston
FNB Bradford Stock Services, Inc.
Penn Bradford Stock Services, Inc.
SPS Options Services, Inc.
TAD Depository Corporation
Western Bradford Trust Company

These representations are made in order that Judges of this Court, inter alia, may evaluate possible disqualifications of recusal.

Morris N. Simkin
Attorney of record for
Petitioners
1700 Broadway, 20th Floor
New York, New York 10019
(212) 581-5800

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES.....	v
NATURE OF THE CASE.....	vii
ISSUES PRESENTED FOR REVIEW.....	vii
RELATED CASE.....	viii
REFERENCE TO PARTIES AND RULINGS.....	viii
STATEMENT OF THE CASE.....	1
Introduction.....	1
A. The Clearing Industry.....	3
1. Processing of Securities Transactions..	3
2. Industry Structure.....	5
3. The Bradford Corporations.....	7
B. A National Clearing System.....	12
1. The Role of Competition.....	12
2. Characteristics of a National Clearing System.....	16
C. The NSCC Consolidation.....	18
D. The Order Under Review.....	22
ARGUMENT.....	28
I. THE COMMISSION FAILED TO MAKE THE DETERMINATIONS REQUIRED BY THE ACT BEFORE APPROVING THE PROPOSED RULE CHANGES.....	28
A. The Commission Did Not Identify and Evaluate the Significant Burdens on Competition Imposed by the Rule Changes.....	28
B. The Commission Failed Properly to Evaluate the Necessity or the Appropriateness of the Rule.....	36

	<u>Page</u>
C. The Commission Failed Properly to Weigh the Anticompetitive Effects of the Rule Changes Against Their Necessity or Appropriateness Under the Act.....	43
D. The Special Representative Rule Is Contrary to the Act.....	49
II. THE COMMISSION'S APPROVAL OF THE RULES CHANGES PRIOR TO SATISFACTION OF THE CONDITIONS TO ITS CONSOLIDATION ORDER AND ELIMINATION OF THE TYING RULES WAS ARBITRARY AND CAPRICIOUS AND NOT IN ACCORDANCE WITH THE EXCHANGE ACT.....	52
CONCLUSION.....	59
APPENDIX I.....	A1

TABLE OF AUTHORITIES

<u>Cases:</u>	<u>Pages</u>
Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971).....	55
Ethyl Corp. v. Environmental Protection Agency, 176 U.S. App.D.C. 373, 541 F.2d 1 (1976) (en banc), cert. denied, 426 U.S.941 (1976).....	46
Greater Boston Television Corp. v. Federal Communications Commission, 43 U.S.App. D.C. 383, 444 F.2d 871(1970), cert. denied, 403 U.S. 923 (1971).....	46
*Industrial Union Department AFL-CIO v. Hodgson, 162 U.S. App. D.C. 331, 499 F.2d 467 (1974).....	41,42,46, 47,57
National Labor Relations Board v. Brown, 380 U.S. 278 (1965).....	46
*Natural Resources Defense Council v. Securities and Exchange Commission, CCH Fed. Sec. L. Rep. ¶96,057 (D.D.C. 1977).....	41,46,47 48,52,57,58
Securities and Exchange Commission v. Chenery Corporation, 318 U.S. 80 (1943).....	42
Udall v. Federal Power Commission, 387 U.S. 428 (1967)....	52
 <u>Statutes:</u>	
Securities Exchange Act of 1934,	
Section 3(a) (23), 15 U.S.C. §78c(a) (23).....	2,4,16,25
*Section 11A(c) (5), 15 U.S.C. §78k-1(c) (5).....	6,49
*Section 17A(a), 15 U.S.C. §78q-1(a).....	12,14,49
*Section 17A(b) (1), 15 U.S.C. §78q-1(b) (1).....	12,14,49
*Section 17A(b) (2), 15 U.S.C. §78q-1(b) (2).....	12,14,49
*Section 17A(b) (3), 15 U.S.C. §78q-1(b) (3).....	14,28,29,52
Section 19(b) (1), 15 U.S.C. §78s(b) (1).....	28,29,40
Section 19(b) (2), 15 U.S.C. §78s(b) (2).....	27,28,29
Section 23(a) (3), 15 U.S.C. §78w(a) (2).....	14
Section 25(a) (1), 15 U.S.C. §78y(a) (1).....	2
Section 25(a) (2), 15 U.S.C. §78y(a) (2).....	2
Section 25(a) (3), 15 U.S.C. §78y(a) (3).....	2
Section 25(a) (4), 15 U.S.C. §78y(a) (4).....	42
Securities Acts Amendments of 1975, 15 U.S.C. §78(nt).12	

<u>Legislative History:</u>	<u>Pages</u>
*Securities Reform Act of 1975, Report of the House Committee on Interstate and Foreign Commerce to Accompany H.R. 4111, H.R. Rep. No. 94-123, 94th Cong., 1st Sess. 51 (1975).....	13,49
*Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S249, S.Rep. No. 94-75, 94th Cong., 1st Sess. 14 (1975).....	14,29,34, 35,42
*Conference Report to Accompany S.249, H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 94 (1975).....	15,29,43
 <u>Rules, Regulations and Releases:</u>	
Sec. Rel. No. 34-13027 (Nov. 30, 1976), 41 Fed. Reg. 53557 (Dec. 7, 1976).....	6
Sec. Rel. No. 34-13163 (Jan. 13, 1977), 42 Fed. Reg. 3916 (Jan. 21, 1977).....	16,18
Sec. Rel. No. 34-13456 (April 21, 1977), 42 Fed. Reg. 21,881 (April 29, 1977).....	1
Sec. Rel. No. 34-13526 (May 10, 1977), 42 Fed. Reg. 25568 (May 18, 1977).....	42,57
 <u>Miscellaneous:</u>	
Barron's National Business And Financial Weekly, (September 12, 1977), Editorial Commentary P.7, "Chosen Instrument? Competition Is Rarely Fostered Through Creating a Monopoly.".....	56,60

*Cases or authorities chiefly relied on are marked by asterisks.

NATURE OF THE CASE

Petitioners, Bradford National Clearing Corporation and Bradford Securities Processing Services, Inc. request the court to reverse an order of the Securities and Exchange Commission ("SEC" or "Commission") approving two rule changes submitted to it by National Securities Clearing Corporation pursuant to Section 19(b) of the Securities Exchange Act of 1934. During the proceedings before the Commission, Petitioners objected to the proposed rule changes on the ground that they would impose burdens on competition not necessary or appropriate to the purposes of the Exchange Act and that their approval would be inconsistent with the prior order of the Commission, conditionally approving the registration of National Securities Clearing Corporation as a clearing agency. The Commission approved the Rule changes. Petitioners timely filed a Petition for Review pursuant to Section 25(a)(1) of the Exchange Act.

ISSUES PRESENTED FOR REVIEW

1. Whether the Commission properly determined that the proposed rule changes do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

2. Whether the Commission's approval of the proposed rule changes is consistent with its order approving (and the conditions imposed on) the registration of National Securities Clearing Corporation.

RELATED CASE

This case is related to Bradford National Clearing Corporation and Bradford Securities Processing Services, Inc. v. Securities and Exchange Commission, No. 77-1199 (D.C. Cir.), currently pending before this Court. The related case is a Petition for Review of an order of the Securities and Exchange Commission granting clearing agency registration under the Securities Exchange Act of 1934 to the National Securities Clearing Corporation.

REFERENCE TO PARTIES AND RULINGS

The Commission order under review, Release No. 34-13456, was issued on April 21, 1977. 42 Fed. Reg. 21,881 (April 29, 1977). It is bound in the Appendix.

SUMMARY OF ARGUMENT

In approving the proposed rule changes, the Securities Exchange Commission failed to make the determinations required under the Securities Exchange Act which are a prerequisite to such approval. It failed in its duty under the Act to assure that a self-regulatory organization does not use its quasi-governmental authority in a manner detrimental to other private interests.

The Commission did not identify and evaluate the anticompetitive implications or burdens imposed by the rule changes. It failed to properly evaluate the necessity or appropriateness of the rules, and made no attempt to strike a proper balance between such competitive burdens and their necessity or appropriateness for the achievement of the purposes of the Act.

Petitioners further argue that the Special Representative Rule is contrary to the Securities Exchange Act in that it eliminates the traditional comparison function of clearing agencies.

The Commission has allowed NSCC both to offer new services and to integrate certain other services prior to satisfaction of the conditions in its own Consolidation Order. This is being done at a time when the tying rules preclude Petitioners and others from offering competing services. The Commission's approval of the rule changes in contravention of the Consolidation Order and in the absence of a clear and reasonable justification, was arbitrary and capricious and not in accordance with the Act.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NO. 77-1547

BRADFORD NATIONAL CLEARING CORPORATION and
BRADFORD SECURITIES PROCESSING SERVICES, INC.,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

NATIONAL SECURITIES CLEARING CORPORATION

Intervenor in Support
of Respondent

Petition For Review Of An Order Of The
Securities And Exchange Commission

BRIEF FOR PETITIONERS

BRADFORD NATIONAL CLEARING CORPORATION and
BRADFORD SECURITIES PROCESSING SERVICES, INC.

STATEMENT OF THE CASE

Introduction

Petitioners, Bradford National Clearing Corporation ("BNCC") and Bradford Securities Processing Services, Inc. ("BSPS"), request the court to reverse an order, Release No. 34-13456 (April 21, 1977), 42 Fed. Reg. 21,881 (April 29, 1977) (hereafter "Rules Order") (App. pp. 120-125), of the Securities and Exchange Commission ("SEC" or "Commission") approving two rule changes submitted to it by National Securities Clearing Corporation ("NSCC") pursuant to Section 19(b), 15 U.S.C. Section 78s(b), of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. Section 78a et seq. (Supp. V. 1975). The first rule change, File No. SR-NSCC-77-1 (App. pp. 37-46) (hereafter the "Bond Rule"), would transfer clearance and settlement of transactions effected in debt securities listed on the American Stock Exchange, Inc. from NSCC's American Stock Exchange Clearing Corporation ("ASECC") Division to NSCC's Stock Clearing Corporation ("SCC") Division. The second rule change, File No. SR-NSCC-77-2 (App. pp. 47-68) (hereafter the "Special Representative Rule"), would expand the class of persons who could act as Special Representative for other participants and non-participants of SCC.

These two rules will have a material anti-competitive effect on Petitioners. BSPS will, as a result of these rules, be precluded from fully developing and limited in the offering

certain of its existing services as well as new services as well as, possibly, losing certain present clients and being precluded from attracting new clients. BNCC's revenues from its facilities management contracts to operate competitors of NSCC will be affected and possibly materially reduced as a result of these two rules. Therefore, Petitioners timely filed their Petition for Review in accordance with Section 25(a)(1) of the Act, 15 U.S.C. Section 78y(a). This brief is submitted in support of that Petition for Review.

The process by which a securities transaction is consummated and the seller receives the proceeds of sale and the buyer receives the securities purchased is known as clearance and settlement. Brokers and dealers and banks act on behalf of their clients, which include members of the public as well as other financial institutions in offering these services. Various types of entities, now defined under the Act as "clearing agencies", Section 3(a)(23), 15 U.S.C. Section 78c(a)(23), act as the intermediaries between these brokers, dealers and banks in completing the exchange of money for securities. These clearing agencies constitute what is known as the clearing industry. An understanding of the functions performed by clearing agencies and the present and projected structure of the clearing industry demonstrates the anti-competitive effect of the Commission's order herein, and the Commission's disregard of its statutory mandate. A brief description of that industry therefore follows:

A. The Clearing Industry

1. Processing of Securities Transactions

Clearing agencies perform a series of operations to effect clearance and settlement. These operations divide into three main parts - comparison, clearance and settlement. As a result of these operations, the parties to securities transactions or those acting on their behalf (hereinafter collectively referred to as "brokers") reach agreement on the specific terms of their transactions; determine their obligations to deliver securities sold and receive securities purchased and to pay for securities purchased and be paid for securities sold; and make the requisite deliveries and payments.

In the first step ("comparison"), the clearing agency compares the information submitted by the selling broker and the buying broker to verify the existence and terms of the trade. If the information submitted by the respective brokers match, a "compared trade" results. If the data does not match, the brokers are notified so that the discrepancy can be reconciled.

The clearing agency then "clears" compared trades by sorting them by broker and advising each broker of his obligation to deliver funds or securities in satisfaction of the trades he has executed. The most rudimentary mechanism for satisfying these obligations would require the broker to make separate payments or delivery for each trade -- i.e. a "trade-for-trade" system. Where the volume of trades in a particular security makes it feasible, the clearing system may offset a broker's

obligations to deliver securities and funds against his rights to receive securities and funds, i.e. "netting," thereby reducing the number of deliveries and payments each broker must make. The netted obligations and rights are then either assigned to another broker ("daily balance order") or to the clearing agency itself. In the latter situation, the clearing agency takes the "other side" of each broker's rights and obligations. This makes possible a "continuous net settlement" ("CNS") system whereby a broker carries forward his net obligation for a given day and nets it against his prior (but unsettled) deliver and receive obligations to the clearing agency.

The obligations identified by the comparison and clearance processes are "settled" by the delivery of the securities to brokers who are net buyers and the payment of money to brokers who are net sellers. Settlement usually occurs five business days after the trade date.

To reduce the number of physical deliveries, the securities industry utilizes depositories which hold securities for their participants. Each participant has an account with the depository, similar to that with a bank except that securities rather than money are involved. To effect settlement in a depository, the delivering party, i.e. the net seller, directs the depository to debit his account and to credit the account of the receiving party, i.e. the net purchaser. This process is known as "book entry movement." These securities depositories are also defined as clearing agencies under the Act (Section 3(a)(23), 15 U.S.C. Section 78c(a)(23)).

2. Industry Structure

NSCC dominates the clearing industry having approximately 85% of the national clearing industry market and some 99% of the New York City clearing industry market. This dominant position is due to the dominant position of the New York Stock Exchange, Inc. ("NYSE") and the American Stock Exchange, Inc. ("Amex") in our nation's securities markets and certain provisions in the Constitution and Rules of the NYSE and the Amex.

Trading of securities on the NYSE constitutes more than 75% of securities trading on all national stock exchanges, while trading on Amex is some 10% of securities trading on all national stock exchanges. NYSE trading is more than 84% of the dollar volume of all exchange trading and approximately 75% of dollar volume of trading in all markets.

The Constitution and Rules of the NYSE require that, absent agreement by the parties that the trade will be cleared and settled directly by the parties, all trades executed on the NYSE must be cleared and settled through the SCC Division of NSCC by a clearing member of SCC. ^{1/} (Cf. NYSE Constitution, Articles XI §3, XII and XIII §2, and NYSE Rules 132, 133, 134, 135, 136, 137, 138, 141, 143, 152, 165, 167, 176, 180, 181, 183, 189, 190, 194, 196, 200, 209, 211, 281, 282, 284, 285, 287, 288, 295, 411 and 412, 2CCH New York Stock Exchange Guide ¶¶ 1503,

^{1/} Prior to the creation of NSCC (Part C, below), SCC was a wholly owned subsidiary of NYSE.

1551-1553, 1602, 2132-2138, 2141, 2143, 2152, 2165, 2167, 2176, 2180, 2181, 2183, 2189, 2190, 2194, 2196, 2200, 2209, 2211, 2281, 2282, 2284, 2285, 2287, 2288, 2295, 2411 and 24112).

As a result all trades executed on NYSE must be compared by SCC. Similar provisions in the Constitution and Rules of the Amex compel comparison, clearance and settlement through ASECC of all trades executed on the Amex. Although the Commission has acknowledged that this "tying" arrangement between NYSE, Amex and NSCC imposes a significant restraint on competition, impedes development of a national clearing system (Part B, below) and is not in conformity with the Act,^{2/} no firm date has been set for its elimination.

2/ Section 11A(c)(5), 15 U.S.C. Section 78k-1(c)(5), provides that "(n)o national securities exchange ...may limit or condition the participation of any member in any registered clearing agency." In Release No. 34-13027 (Nov. 30, 1976), 41 Fed. Reg. 53557 (Dec. 7, 1976), the Commission stated:

These rules and procedures have become restraints on competition by tying the clearance and settlement of securities transactions to the market in which those transactions occur and have impeded the development of efficient methods of clearance and settlement by discouraging technological innovation. For example, the rules of several national securities exchanges and of the NASD subject securities contracts to the requirements of the by-laws and rules of clearing agencies affiliated with those organizations, even though members of such exchanges and the NASD might prefer to utilize other clearing agencies. (Citation omitted.)

The other clearing agencies competing directly with NSCC are petitioner BSPS and four regional clearing corporations,^{3/} each of which is affiliated with a regional stock exchange. The regional clearing agencies perform the various functions described above for trades executed on the regional stock exchanges. In a national clearance system (see Part B, below), these regional clearing agencies and petitioners will compete with NSCC (to the extent possible in light of NSCC's virtual monopoly position) for clearing business. Despite their small market shares, these clearing agencies have been responsible for development of most of the major innovations -- such as the "continuous net settlement system" -- in the clearing industry.

3. The Bradford Corporations

Petitioner BNCC is a facilities manager and as such provides, on a contract basis, the physical space, computers and personnel necessary to perform the processing services for the clearing and settlement of securities transactions as outlined above. Under these contracts BNCC performs all services offered by the contracting party and undertakes research and development activities aimed at refining existing services and developing new ones. BNCC is currently the facilities manager for the NCC

^{3/} Midwest Clearing Corporation is a subsidiary of the Midwest Stock Exchange; Boston Stock Exchange Clearing Corporation is a subsidiary of the Boston Stock Exchange; Pacific Clearing Corporation is a subsidiary of the Pacific Stock Exchange; and Stock Clearing Corporation in Philadelphia is a subsidiary of the Philadelphia Stock Exchange.

Division of NSCC, the Pacific Clearing Corporation and the Pacific Securities Depository Trust Company. The latter two are also registered with the SEC as clearing agencies. The Bond Rule and Special Representative Rule will adversely effect the Pacific Clearing Corporation and the Pacific Securities Depository Trust Company by, among other things, reducing the volume of securities transactions they process. This volume reduction will adversely affect BNCC because its fees under the facilities management contract with these two clearing agencies are dependent, in part, on the volume of securities transactions processed.

Petitioner BSPS is a registered clearing agency under the Act. BSPS developed a system for and currently offers comparison, clearance and settlement services for transactions in municipal bonds and U.S. Government issued or guaranteed securities. BSPS also offers clearance and settlement services for transactions in corporate bonds and equity securities. In performing these services BSPS also offers a service to deliver or receive these securities against payment of the purchase price and arranging the financing therefor. These services are offered so that a client can choose to use whichever of BSPS's services it desires for all or some of the securities that may be processed by BSPS. Because the trading volume in each of the securities cleared by BSPS does not make netting feasible,

BSPS uses a trade-for-trade settlement system.^{4/}

In comparing and confirming trades, BSPS offers participants a fixed income accounting service ("FIAS"). FIAS takes the data a participant has generated regarding all customer orders received and all trades executed and the terms thereof and prepares all the required blotters, books and records for the participant. Among these documents is the confirmation setting forth the terms of the trade as reflected by that participant's records. This confirmation is sent to the other side of the trade who then compares it with his records to verify the terms of the trade.

BSPS also acts as agent for its participants in delivering and receiving funds and securities for compared or confirmed transactions. A participant will advise BSPS of a confirmed trade. If a participant has sold the securities, BSPS will arrange for delivery of the security either from its vault or otherwise, e.g., from the participant, a custodian bank, a pledgee bank, etc. If requested, BSPS will arrange financing so that upon receipt of the sold security by BSPS the participant will receive a portion of the proceeds of sale. This service is particularly useful for a participant who may have

^{4/} A certain minimum trade volume is necessary to make netting feasible. In a trade-for-trade system, the clearing service provides daily records of the participants's trading activity and settlement occurs five business days after the trade date.

pledged the subject security. BSPS will then deliver the security to the buyer against receipt of the purchase price, and deliver the proceeds to the participant or the lending bank, as the case may be.

On the other side, when a participant buys a security, BSPS, as agent for the buyer-participant, will physically receive delivery of the security from the seller. If the purchase price has not been paid to the seller, the participant will either deposit the purchase price with BSPS or request BSPS to arrange financing against delivery of the security. If the purchase price has been paid, BSPS will receive the securities without making or arranging any payment therefor, for disposition in accordance with its participant's instructions.

The services offered by BSPS do not include a CNS system similar to that offered by NSCC and certain of the regional clearing agencies. As noted above, the NYSE and Amex currently have rules which compel the members of those organizations to compare, clear and settle trades effected on those exchanges through NSCC. These "tying" rules preclude BSPS from competing with NSCC for the comparison, clearing and settlement of the vast majority of transactions in high volume securities. As long as entry to this market is closed, BSPS will be precluded from obtaining the transaction volume necessary to justify development of CNS clearing. Firms which use BSPS for some clearing services will continue to be locked in to NSCC for all NYSE and Amex transactions.

BSPS mailed to the SEC a Form 19b-4A on August 24, 1977 in which BSPS proposed to amend its rules and fee schedule to offer a trade comparison and reporting service. This service would be similar to the comparison service offered by NSCC. BSPS participants could use this service to compare trades, regardless of where executed and regardless of whether or not the other side submitted the trade to BSPS for comparison. Further, BSPS's proposal would not compel a participant to use this service, but, rather was so structured as to leave completely to the participant the decision whether or not to use the service.

The Form 19b-4A, as mailed to the SEC, went on to state that the development and offering of a comparison service was part of a program BSPS had adopted to develop and establish a full clearance and settlement system for all securities. BSPS has expended considerable sums and devoted many hours of employee time to developing a trade comparison system and clearance and settlement system. The Special Representative Rule together with the Bond Rule will limit BSPS's ability to offer its comparison and settlement service to present and prospective participants for trades in securities which are cleared by SCC and where the contra side is a Special Representative. In light of the substantial volume of activity from securities cleared by SCC and the fact that SCC members who can become Special Representatives are the major brokerage firms, this means loss of a substantial market for these BSPS services.

Similarly, BNCC's clients, Pacific Clearing Corporation and Pacific Securities Depository Trust Company, will lose business because of these rules. As BNCC's fees from these clients depends, in part, on the volume of transactions processed for them, this will result in a reduction of BNCC's revenues, which may be material.

B. A National Clearing System

1. The Role of Competition

In 1975, the Congress enacted significant amendments to the Act ["Securities Acts Amendments of 1975", Pub. L. No. 94-29 (June 4, 1975) (hereafter the "1975 Amendments")] designed to effectuate development of a national market system ("NMS") for the trading of securities and a national clearing system ("NCS") for the comparison, clearance and settlement of securities transactions.

Section 17A of the Act, 15 U.S.C. §78q-1, was added by the 1975 Amendments and mandates the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions. This result is to be accomplished by the linking of all clearance and settlement facilities, the use of new data processing and communications techniques, development of uniform standards and procedures, and elimination of inefficient clearance and settlement procedures. Section 17A(a)(1), 15 U.S.C. §78q-1(a)(1). While recognizing increased efficiency and elimination of unnecessary

costs and facilities as desirable effects of the development of an integrated system, Congress also mandated that competition play an important role in the development and operation of that system.

The 1975 Amendments did not contemplate the mere consolidation of existing facilities and the creation of one massive clearing agency. The importance of creating an environment in which additional entities such as the petitioners could enter and compete in the clearing industry was noted by the House Committee on Interstate and Foreign Commerce which stated:

It should be made clear that the statutory charge to develop a unified system for the clearance and settlement of securities transactions does not carry with it the call -- nor does it grant the authority -- to eliminate competition among separate entities in the performance of these functions. Many of the innovations and improvements in clearance and settlement of the last several years have been the product of vigorous and healthy competition among different service entities. Often new market entrants have been responsible for the most significant advances. The Committee believes, therefore, that a national system, though fully integrated, must make full allowance for the continuance and future entry of separate service entities.

Securities Reform Act of 1975, Report of the House Committee on Interstate and Foreign Commerce to Accompany H.R. 4111, H.R. Rep. No. 94-123, 94th Cong., 1st Sess. 51 (1975) (hereafter "Report on H.R. 4111").

In addition to providing a clearing industry structure that fosters competitive opportunities, the Commission was directed to exercise its oversight authority to monitor clearing agency operations and to ascertain the potential anti-competitive impact of those operations. Section 17A(b)(3)(I), 15 U.S.C. §78q-1(b)(3)(I). Further, in carrying out its statutory responsibilities to "facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities...", Section 17A(a)(2), 15 U.S.C. §78q-1(a)(2), the Commission is required to have due regard, inter alia, for the "maintenance of fair competition among... clearing agencies..." Id. Actions by clearing agencies or the Commission that impose any burden on competition must be justified by a showing that they are necessary or appropriate in furtherance of the purposes of the Act. Sections 17A(b)(3)(I) and 23(a)(2), 15 U.S.C. §§78q-1(b)(3)(I), 78w(a)(2). Thus, as the Senate Committee on Banking, Housing and Urban Affairs stated, the 1975 Amendments were "designed to force the Commission to focus with particularity on the competitive implications of each regulatory requirement." Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S.249, S.Rep. No. 94-75, 94th Cong., 1st Sess. 14 (1975) (hereafter the "Report on S.249").

The Conference Report on the 1975 Amendments further emphasized the importance of competition in the development of a national system for the execution and clearance of securities transactions:

[T]he Senate bill [S.249] charged the SEC with an explicit and pervasive obligation to eliminate all present and future competitive restraints that could not be justified by the purposes of the Exchange Act. The Commission was directed to remove existing burdens on competition and to refrain from imposing, or permitting to be imposed, any new regulatory burden "not necessary or appropriate in furtherance of the purposes" of the Exchange Act. Thus, the Commission was obligated to review existing and proposed rules of the self-regulatory organizations [which include clearing agencies] and to abrogate any present rule, or to disapprove any proposed rule imposing a competitive restraint neither necessary nor appropriate in furtherance of a legitimate regulatory objective....Further, the Commission was required to evaluate its own regulatory proposals in light of the fundamental national economic policy of furthering competition and was prohibited from promulgating any rule which imposed a burden on competition not necessary or appropriate to achieve the purposes of the Exchange Act. The Commission's responsibility under the Senate bill is to balance the perceived anti-competitive effects of a regulatory policy or decision (whether its own or that of a self-regulatory organization) against the purposes of the Exchange Act that are advanced thereby and the costs of doing so.

Conference Report to Accompany S.249, H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 94 (1975) (hereafter "Conference Report").

The Conference accepted the approach and provisions of the Senate bill, S. 249, which strengthened and made explicit the underlying objectives of the House bill, H.R. 4111. See p. 13, supra.

2. Characteristics of a National Clearing System

The basic objectives of a national clearing system are to allow a participant, Section 3(a)(24), 15 U.S.C. §78c(a)(24), to compare, account for and settle through one clearing agency all trades in securities included in the system, regardless of the location of the other party to the trade or the market in which it is executed (so-called "one account processing"), and to enable that participant to deposit and maintain its securities in a securities depository (which is also a "clearing agency" for purposes of the Act, Section 3(a)(23)(A), 15 U.S.C. §78c (a)(23)(A)), so that securities may be transferred by book entry movements from one participant to a participant in the same or another securities depository in settlement of clearing obligations, to effect pledges and to perform other functions. SEC Rel. No. 34-13163, 23-24 (Jan. 13, 1977) (App. pp. 1-36). In such a national clearing system a participant would be able to make a single daily money settlement and could redeliver securities on the same day they are received. Id.

A necessary ingredient in a national clearing system is an electronic communications network linking all clearing agencies to one another by computer. These electronic links are referred to as "interfaces." At the present time

a pilot interface program for NYSE listed issues -- the Regional Interface Organization ("RIO"), and an interface between NCC and the Pacific Clearing Corporation for over-the-counter transactions are operational. RIO allows certain of the clearing agencies affiliated with exchanges to route compared trades to any other participating clearing agency for clearance and settlement provided that participants whose trades are so routed are participants in both of the interfacing clearing agencies.^{6/} Because Petitioner BSPS is not affiliated with any stock exchange, it is not a participant in RIO, and does not have any interface with any other clearing agency.

As noted by the Commission, imposition of interface charges by SCC^{7/} and SCC's lack of cooperation with other clearing agencies have seriously curtailed the development of additional interfaces. The present interface system is thus limited in nature and has proven costly to brokers who use it.

^{6/} The present participants in RIO include the SCC Division of NSCC which is affiliated with the NYSE, the ASECC Division of NSCC which is affiliated with Amex and three regional clearing agencies, Midwest Clearing Corporation, Pacific Clearing Corporation and Stock Clearing Corporation of Philadelphia.

^{7/} NSCC has recently announced its intention not to impose an interface charge when the clearing agency on the other side does not impose a similar fee. However, NSCC's sister corporation, Depository Trust Company (DTC), a securities depository and registered clearing agency, has proposed to charge an interface charge. NSCC holds no securities. As presently operated NSCC participants can most effectively use its CNS system if they also use DTC. The effect of these actions is to shift from NSCC to DTC the onus of imposing an interface charge.

C. The NSCC Consolidation

Following proceedings instituted pursuant to Sections 17A(b) and 19(a)(1)(B) of the Act, the Commission approved the clearing agency registration of NSCC as assignee of the operations of the clearing agencies for the NYSE, the Amex and the over-the-counter market (National Clearing Corporation ("NCC")).^{8/} This combined entity has a market share of 85% of total clearing agency business and 99% of that in New York City.

Petitioners, the Department of Justice, and others vigorously opposed the NSCC consolidation on the ground that it would have a grossly anticompetitive impact on the clearing industry in obvious derogation of the requirements of the Act.^{9/} In an attempt to counter this anticompetitive impact, the Commission imposed four conditions on NSCC in its order approving the clearing agency registration of NSCC, SEC Rel. No. 34-13163, Jan. 13, 1977 (hereafter "Consolidation Order"). The Commission's approval was based on its assertion that "the conditions imposed by this order will counter the negative consequences which might otherwise result from NSCC's establishment." Id. at 68. (App. at 15).

^{8/} The over-the-counter market consists of a network of telephone lines and a computerized quotation system and operates under the auspices of the National Association of Securities Dealers ("NASD") pursuant to Section 15A of the Act. Prior to the creation of NSCC, the NASD owned 100% of the stock of NCC. As noted above, ASECC and SCC were wholly owned subsidiaries of the Amex and NYSE respectively.

^{9/} Petitioners have filed a Petition for Review of the Commission's approval of the NSCC consolidation. BNCC and BSPS v. Securities and Exchange Commission, No. 77-1199 (D.C. Cir.). Nothing contained herein is intended (or should be construed) to waive, modify, or be in derogation of any rights or positions asserted in that case.

The Consolidation Order contemplated an initial period ("Phase I") during which the four conditions would be fulfilled. Id. at 43-44; 68-70. (App. at 9-10; 15-16). Prior to completion of Phase I, NSCC was not to be permitted to operate as a single integrated entity ("Phase II"). Thus, during Phase I, NSCC is required to operate the business of each of the three clearing entities as a separate NSCC Division -- the ASECC Division, the NCC Division and the SCC Division -- with each division operating "under substantially the same rules, procedures and agreements used by the division's predecessor clearing agency." Id. at 43. (App. at 9).

One of the feared anticompetitive results of the creation of NSCC was that because of its sheer size and monopoly position in the clearing industry, NSCC would obstruct achievement of a national clearing system by discouraging interfaces with other clearing entities, engaging in delaying tactics and generally refusing to cooperate in the development of common industry facilities. The Commission's response to this fear was to impose the so-called "Free Interface Condition" on NSCC. Id. at 68-69, 117. (App. at 15, 25). This condition requires NSCC to establish full interfaces ^{10/} with clearing agencies having a CNS system, and "appropriate links" with certain other clearing systems, before it may begin Phase II operations. According to the Commission, Id. at 69-70. (App. at 15):

^{10/} The Consolidation Order defines a "full interface" as "one through which any participant in either of the interfacing clearing corporations can move all its transactions in issues eligible for comparison, clearing and settlement at both clearing corporations." Consolidation Order at 69, n. 121. (App. at 31).

As a result of the Free Interface Condition, NSCC [would] not be able to offer services other than those offered presently by its operating divisions until each of the clearing corporations which must establish links with NSCC in order to provide the accounting and settlement component of one account processing has, in the judgment of the Commission, completed or had an adequate opportunity to complete arrangements with NSCC necessary to enable it to provide services comparable to those which NSCC intends to provide.

At the time the Consolidation Order was entered Petitioners were told that as they did not provide clearance services on a CNS basis, they were not specifically identified in the Free Interface Condition. Petitioners were further advised that once Bradford developed a CNS system, it too would come within the coverage of the condition. ^{11/}

During the NSCC consolidation proceedings, the Department of Justice and regional clearing agencies expressed concern that the merger's possible anticompetitive effects could not be reversed if NSCC failed to satisfy the SEC's conditions. They feared that NSCC would obtain an insuperable competitive advantage over its potential competitors during the interim period by offering to provide prospective participants the advantages of one account processing at the start of NSCC's integrated operations while suggesting that competing clearing

^{11/} As noted above, BSPS will be unable to compete for the business necessary to develop sufficient volume for a CNS system as long as the New York "tying" rules are in effect. Thus, elimination of the "tying" rules is critical to BSPS's being able to interface (and compete) with other clearing agencies. However, as described below, *infra* Argument I.D., the Special Representative Rule will have the same effect as the tying rules. So removal of the tying rules without removing the Special Representative Rule leaves BSPS no better off than it is today.

corporations would be unable to offer comparable services or to offer them as soon as NSCC. (Consolidation Order at 79, App. at 18).

Again, the Commission sought to meet these objections by reliance on the conditions. It recognized that "undoing the limited combination which would be effected during Phase I by NSCC's registration would not be without difficulty," but stated that "the requirement that Phase II operations not be initiated until the conditions are satisfied is intended to insure that no irreversible steps are taken before the installation of mechanisms which the Commission believes will prevent Phase II operations from imposing unnecessary or inappropriate burdens on competition." Id. at 81, (App. at 17).

Finally, the Commission concluded, Id. at 81-82, (App. at 17):

The conditions to NSCC's registration contained in this order are intended to ensure, among other things, that NSCC will not prevent competing clearing corporations which must interact and cooperate with it from providing, contemporaneously with NSCC, services similar to those it will provide in Phase II.... In view of the conditions contained in this order and the Commission's expressed intention to exercise its authority under the Act to ensure that NSCC does not make inappropriate use of its pivotal position, the Commission does not believe that, during the interim before implementation of Phase II, competing clearing corporations will be disadvantaged in their efforts to market the kinds of services which NSCC intends to provide in Phase II. (Emphasis added.)

D. The Order Under Review

The Commission's Rules Order approved two rules changes submitted by NSCC which would change the manner in which its SCC Division operates. The first change, the Bond Rule, would transfer the comparison, clearance and settlement function for debt securities listed on the Amex from ASECC to SCC. This change creates one integrated system in SCC to perform comparison, clearance and settlement of trades in debt securities listed on the NYSE and Amex. Prior to this change there had been two such systems one of which (SCC) handled trades in debt securities listed on the NYSE and the other (ASECC) handled trades in debt securities listed on the Amex.

The second change, the Special Representative Rule, completely changed the class of entities which may act as a "Special Representative" and significantly altered and materially expanded the services a "Special Representative" may perform, including the types of transactions and parties thereto which may be entered into SCC's CNS system by a "Special Representative." The Special Representative Rule and the Bond Rule (hereinafter the "rule changes") considered by themselves or more particularly when combined with the established business practices resulting from the tying rules of the NYSE and Amex together with the trading market dominance of the NYSE and Amex allow NSCC to offer services no other clearing agency can offer and limit the ability of other clearing agencies to compete directly with NSCC.

The Bond Rule adds to the list of "Cleared Securities" in SCC and removes from the list of "Cleared Securities" in ASECC "all debt securities listed from time to time on the American Stock Exchange, Inc." (App. at 38). Participants may use SCC's and ASECC's comparison, clearance and settlement services and in turn their respective CNS systems for transactions in securities on the respective lists of "Cleared Securities." NSCC stated that the purpose of the Bond Rule was in anticipation of the establishment of interfaces with certain regional clearing agencies as required in the Consolidation Order and because the "data processing capability" NSCC has developed to implement these interfaces "will work most efficiently if it operates in connection with a single NSCC division rather than two or three NSCC divisions." (App. at 39). These interfaces have not yet been full established. The result is that SCC is the only entity with a single integrated system offering comparison, clearance and settlement for transactions in all debt securities listed on the NYSE and Amex.

The Special Representative Rule is a very technical and complex provision with many regulatory implications. In fact it is so complex that apparently even NSCC was confused as to its implications leading an SEC staff member to state "...there were a couple of references in the submission that oughtn't to have been there...." (App. at 110). Prior to the rule change, the Special Representative Rule allowed only odd lot dealers on the NYSE to submit to SCC for comparison, clearance and settlement trade data for their trades for both themselves and

the other party to the trade. The rule change expanded the class of "Special Representative" and the services a "Special Representative" may offer in several major ways, a number of which are listed below.

A "Special Representative" is either a "Member" or a clearing agency registered as such with the SEC which has applied to SCC to be a "Special Representative" and designated the Members and non-participants for which it will act. (App. at 51).^{12/}

A number of Clearing Members have entered into "Clearance Agreements" with other Members and non-participants in SCC to act as their agent in performing comparison, clearance and settlement for securities transactions effected by these Members and non-participants. These Clearing Members who have entered into such "Clearance Agreements" compete directly with Petitioners in offering such services. As will be shown below, the Special Representative Rule strengthens the ability of Clearing Members

^{12/} SCC has several classes of "Member". These include:
i) Clearing Members which are, essentially, broker-dealers belonging to a national stock exchange or registered securities association which broker-dealers have been approved by SCC and have made the required contribution to SCC's Clearing Fund (SCC Rule 2, Section 1, 2 CCH New York Stock Exchange Guide, ¶ 3302); ii) Associate Members which include banks, trust companies, insurance companies, corporations which are "clearing corporations" as defined in Article 8 of the Uniform Commercial Code, and investment companies registered with the SEC which have been approved and contributed to SCC's Clearing Fund (SCC Rule 2, Section 2, 2 CCH New York Stock Exchange Guide, ¶ 3302); and iii) Affiliate Members which include clearing agencies affiliated with a national securities exchange, which apply for such membership, are approved by SCC and make the required contribution to SCC's Clearing Fund (SCC Rule 2, Section 3, 2 CCH New York Stock Exchange Guide, ¶ 3302).

of SCC, and in turn SCC itself, to take away present and prospective clients of other clearing agencies.

A Special Representative may submit to SCC for comparison data for trades in any security SCC states is "acceptable" and which is between Members. (App. at 48).^{13/} If such trade compares, the Member, which is a party thereto and is not a Clearing Member, is bound by the terms and the trade may be processed through SCC's clearance and settlement operations producing a CNS delivery obligation. This allows participants such as banks and other financial institutions to obtain directly the netting benefits of the CNS system. This is illustrated in SCC's submission to the SEC which states that Depository Trust Company

"...might as to transactions confirmed by a broker and its customer in DTC's ID System submit both sides of the transaction to the SCC Division for settlement in the SCC Division CNS System whereupon the selling side (e.g. the customer) would have a CNS obligation to deliver to the SCC Division and the buying side (the broker) would have a CNS obligation to receive from the SCC Division. This would involve non-Clearing Member Customers of Clearing Members in CNS transactions and provide the netting benefits of the CNS System to such non-Clearing Members." (App. at 53.)

Yet these non-Clearing Members are also prospective customers of other clearing agencies for these same services. Many of BSPS's clients would be affected by this proposal. Because of the costs

^{13/} There is no explanation of whether "acceptable securities" include securities other than "Cleared Securities". If it does, the Special Representative Rule has even more broad ranging and profound implications than those discussed below.

and added burdens of physically obtaining and delivering securities to BSPS these clients would be attracted to the use of a Special Representative.

The Special Representative Rule permits a Special Representative to submit trade data for "acceptable" securities (netted or otherwise) for comparison to SCC, and if such data calls for delivery of "acceptable" securities to a non-participant, the Special Representative either designates a clearing agency which assumes the obligation of the non-participant or the Special Representative guarantees such obligation. (App. at 49). As illustrated by SCC's submission to the SEC this would enable a Member which has a trade with a participant in another clearing agency which is interfaced with NSCC to have such trade settled through the Regional Interface Organization ("RIO"), (App. at 54). As such, this rule change discriminates against BSPS which is not a participant in RIO and with which NSCC is not required to interface under the Consolidation Order. Further, the Special Representative Rule is so drafted that it could enable a Special Representative to use SCC's comparison system and SCC's to be established branch offices to handle trades with non-participants with whom the Special Representative trades, if the Special Representative guarantees the trade or a registered clearing agency assumes the obligation. These non-participants are the present and prospective clients for the full array of clearing securities offered by BSPS and other clearing agencies. The rule change allows SCC to take this business away and, in effect, service

non-participants if the Special Representative will bear the risk, inherent in all contracts/trades, that the non-participant in SCC will breach its trade contract.

Another aspect is that this rule proposal hinders the ability of other clearing agencies to perform trade comparison. The Special Representative will be strongly tempted to submit to SCC data regarding all trades in "eligible securities" with non-participants. SCC will in turn transmit such data to the non-participant's clearing agency, if that clearing agency has indicated it will act for that non-participant, or to the Special Representative for that non-participant, SCC will then effect delivery. The result will be that other clearing agencies rather than competing with SCC to offer comparison services will be forced to become Members of SCC in order to compare trades between their participants and Special Representatives. Not only will this put these other clearing agencies at a serious competitive disadvantage, it is a violation of the Act.

These rule changes were published for comment in accordance with Section 19(b) of the Act and SEC rule 19b-4, 17 CFR §240.19b-4 (1977). Four comment letters were received, all of which raised objections to the proposed changes. Three letters requested that the Commission institute proceedings pursuant to Section 19(b)(2)(B), 15 U.S.C. §78s(b)(B), to determine whether the rule changes should be disapproved. (App. at 91-103).

A open meeting was held by the Commission at which the rule changes were discussed. (App. at 106-119). At the conclusion of the meeting the rule changes were approved. The Rules Order states that the rule changes are "designed to implement 'The Free Interface Condition'" to the Consolidation Order.

ARGUMENT

I. THE COMMISSION FAILED TO MAKE THE DETERMINATIONS REQUIRED BY THE ACT BEFORE APPROVING THE PROPOSED RULE CHANGES.

A. The Commission Did Not Identify and Evaluate the Significant Burdens on Competition Imposed by the Rule Changes.

Under the structure of the Act, a proposed rule change of a registered clearing agency must be filed with the Commission. Section 19(b), 15 U.S.C. §78s(b). After notice and opportunity for public comment, the Commission must either enter an order approving the proposed rule change as consistent with the requirements of the Act, or institute proceedings to determine whether the rule change should be disapproved. Section 19(b)(2), 15 U.S.C. §78s(b)(2). No proposed rule change of a clearing agency may take effect unless it is approved by the Commission. Section 19(b)(1), 15 U.S.C. §78s(b)(1).

In making a determination that a proposed rule change is consistent with the requirements of the Act, the Commission, inter alia, must find that the rule change does not "impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]." Section 17A(b)(3)(I),

15 U.S.C. §78q-1(b)(3)(I). This obligation for the Commission to evaluate the anticompetitive implications of self-regulatory rules was added to the Act by the 1975 Amendments, and it was viewed by the Congress as "an explicit and pervasive obligation" to refuse to approve a rule change that creates a competitive restraint that cannot be "justified by the purposes of the Exchange Act." Conference Report at 94.

In carrying out this statutory obligation, the Commission is required to "focus with particularity on the competitive implications of each regulatory requirement." Report on S.249 at 14. Where the proposal has demonstrable anticompetitive consequences, "the Commission's responsibility [is] to balance the perceived anticompetitive effects of the regulatory policy or decision at issue against the purposes of the Exchange Act that would be advanced thereby and the costs of doing so." Report on S.249 at 13-14; see, Conference Report at 94.

Contrary to its statutory mandate, in reviewing the rule changes at issue in this case and entering the Rules Order, the Commission failed to identify and evaluate the serious competitive burdens involved. Thus, it failed in its most elementary duty under the Act to assure that a self-regulatory organization does not use its quasi-governmental authority for essentially selfish purposes in a manner "unfair to [other] private interests." Report on S.249 at 23.

There are several significant and potentially far reaching anticompetitive implications of the instant rule changes. These include the following:

1. The Bond Rule permits the de facto integration of the bond operation of the ADESC Division of NSCC with that of the SCC Division of NSCC. This gives NSCC the ability to compare, clear and settle transactions in all listed bonds through a single system. No other competing clearing agency has this ability and no other competing clearing agency can obtain or develop this ability so long as the NYSE and Amex tying rules remain in effect. Furthermore, the creation of this single system brings all such bonds into the interface between NSCC and the three regional clearing agencies -- an interface in which Petitioners do not participate. Petitioners do not argue that the integration accomplished by the Bond Rule has no public benefits, or that at no point in time would it be appropriate for the development of a national clearing system. The point is simply that the accomplishment of this integration at this time -- when no other competing clearing agency is able to compare transactions in these bonds which occur on the NYSE or Amex and only those few clearing agencies participating in the RIO interface are able to clear and settle such transactions in very limited circumstances -- further enhances the dominant competitive position of NSCC.

The Bond Rule allows NSCC to offer partici-

pants and potential clearing agency participants a single operational facility -- the SCC Division of NSCC -- to handle all clearing functions for transactions in listed bonds. At the same time, the rules of two of NSCC's three shareholders, the NYSE and the Amex, preclude anyone else from offering a similar facility. Obviously, the Bond Rule thereby impose serious burdens on competition among clearing agencies.

2. The Special Representative Rule significantly expands the types of organizations that can directly participate in the CNS operations of the SCC Division. Through the use of a Special Representative, banks, insurance companies and other qualified financial institutions may now directly clear their own securities transactions in the CNS system rather than relying on a broker acting on their behalf. These financial institutions are petitioners' traditional customers. Historically, because they are not members of stock exchanges, they either cleared their transactions through a broker which was a participant in a clearing agency, such as those with whom BNCC has a facilities management contract, or used someone performing functions similar to those performed by BSPS to accomplish the clearance and settlement of their transactions. Again, Petitioners do not challenge the ultimate desirability of opening direct participation in NSCC to a wider group of institutions. Nor are Petitioners opposed to competing with NSCC or its members acting as Special Representatives. However, the significant expansion of NSCC services to a significant group of Petitioners'

historical customers at a time when Petitioners are foreclosed by regulatory requirements from competing for the vast majority of NSCC's business, significantly increases NSCC's already enormous competitive advantage. The Special Representative Rule thus imposes significant burdens on competition among clearing agencies.

3. The Special Representative Rule also expands the extent of NSCC's incursion into Petitioners' traditional areas by permitting smaller brokerage firms ("correspondent firms") which have traditionally cleared their securities transactions through other brokerage firms ("clearing firms"), to clear their transactions directly in NSCC. These correspondent firms are the type of broker-dealers that Petitioners have traditionally serviced. By permitting clearing firms to act as Special Representatives for correspondent firms, the Special Representative Rule may make it significantly less expensive for correspondent firms to clear and settle their securities transactions through NSCC. Reducing costs is a desirable result. However, its accomplishment at this time, when Petitioners are precluded from offering similar services to such correspondent firms, may well impose such a burden on competition that the NSCC monopoly will become complete. The possible short term cost savings for correspondent firms does not obviate the serious burdens on competition among clearing agencies imposed by implementing the Special Representative Rule at this time.

4. The Special Representative Rule permits a Special Representative to act on behalf of a non-participant in NSCC. Under this arrangement, non-participants which are participants in one of the regional clearing agencies interfaced with NSCC and non-participants whose trades are guaranteed by a Special Representative may clear and settle securities transactions executed on their behalf in securities listed on the NYSE and Amex debt listed securities either in such interfaced clearing agency or in SCC. Petitioners do not have an interface with SCC, and are unable to justify developing one so long as the anti-competitive tying rules remain in effect. Therefore potential BSPS participants are unable to utilize the Special Representative provisions to clear and settle through BSPS. Thus, an additional burden on competition among clearing agencies is imposed.

5. The Special Representative Rule will compel the Special Representative to report to SCC all trades with non-participants in "acceptable" securities. These clearing agency acting for non-participants in SCC will be compelled to use SCC to compare the trade reported to them by their participants and reported to SCC by the Special Representative. This will force other clearing agencies to charge their participants their fees for comparison and the fees SCC charges that clearing agency. In these situations, the other clearing agencies will be competitively disadvantaged by the loss of prospective clients for their comparison service or by the need to charge

their clients two fees for comparison -- their fees and SCC's fees or to stop offering comparison services in "acceptable" securities and use SCC's comparison services.

Despite Petitioners' objections to the Bond Rule and the Special Representative Rule, the Commission made no effort to "focus with particularity on the competitive implications of [these] regulatory requirement[s]." Report on S.249 at 14. To the contrary, the Commission identified none of these competitive burdens and even went so far in the Rules Order to suggest that the changes would be pro-competitive.

During the Commission's consideration of NSCC's proposed rule changes the following interchange occurred between members of the Commission and the staff:

COMMISSIONER LOOMIS:

We've come then to item 3, the rule proposals filed by the National Securities Clearing Corporation. Gentlemen, I understand your feeling is that notwithstanding the concern expressed in the comments, this really isn't a major substantive decision, and it does facilitate interfaces rather than interfere with them.

MR. NULAND:
Correct.

COMMISSIONER EVANS:

I think it is very important, Tony, that we know that to be a fact. Because, as I read it, Bradford may be the only real competitor with NSCC in many instances and to the extent that anything is done that would jeopardize their ability to compete, I think we need to be very concerned.

MR. NULAND:
Quite.
(emphasis added)

Despite the Commission's apparent realization that Petitioners are "the only real competitor[s] with NSCC in many instances", at no point during the consideration of the proposed rule changes was there a discussion of the specific competitive burdens that would thereby be imposed. In fact, Commissioner Loomis stated: "You don't feel this is a major step or perhaps the proper place in which to focus the significant competitive issues here" (App. at 108). and was advised by the SEC staff that that was correct. Similarly, the Rules Order contains no identification or evaluation of these competitive burdens. Such an approach does not satisfy the Act's mandate that the Commission "focus with particularity on the competitive implications of each regulatory requirement." Report on S.249 at 14. Indeed, because of the Commission's failure to identify the competitive disadvantages to Petitioners that would result from its action, it took the cavalier attitude that the matter before it "really isn't a major substantive decision."

The Commission failed to focus on the possibility that by allowing NSCC to expand its services and consolidate its operations, the already formidable barriers to Petitioners' entry into the major clearing market would be raised even higher. Indeed, as long as the New York "tying" rules remain in effect, Petitioners are effectively barred from competing for any share of that market. When combined with NSCC's already substantial leverage in those areas where it presently competes with Petitioners, the anticompetitive consequences of approving NSCC's rule changes should have been manifest to the Commission.

B. The Commission Failed Properly to Evaluate
the Necessity or Appropriateness of the
Rule Changes

At the Commission meeting at which the rule changes were approved, the following colloquy occurred between Commissioner Evans and a member of the Commission's staff:

COMMISSIONER EVANS:

I guess I had sort of anticipated that NSCC would come in with an overall plan as to how they would get us to Phase II, and it would sort of all happen at the same time. To this extent it comes in piecemeal, I think we should be very careful to assure that they aren't somehow cementing their monopoly position in a way that would be inappropriate.

MR. NULAND:

Well, I think our intent is to prevent that from happening. NSCC will shortly file an overall plan. It has circulated a draft overall plan to all interested clearing corporations, including Bradford National Corporation and its subsidiaries. The implementation of the order must proceed piecemeal, with something that is going to take, if you remember, we estimated some six months, to piece together. Everything can't be done at once. There has to be a block and another block, and so forth.

(App. 106-107). Later during the same meeting, Commissioner Loomis picked up on the same point and stated "I gather you don't expect it [i.e. the achievement of Phase II] to be done at once". To which Mr. Nuland replied, "No, it can't be done all at once". (App. at 115).

The question of the amount of progress that the Commission will allow NSCC to make toward Phase II prior to its fulfillment of the four conditions in the Consolidation Order is a matter of tremendous concern to all clearing agencies competing with NSCC. If NSCC is allowed to "creep" toward PHase II without significant progress being made toward satisfying the conditions, enormous competitive injury will be done to the other clearing agencies. In other words, the closer NSCC gets to Phase II before the conditions in the Consolidation Order are met, the greater competitive advantage it enjoys.^{14/}

^{14/} This competitive advantage was recognized by Chairman Williams during recent hearings regarding the Commission's administration of the 1975 Amendments. In discussing the period during which NSCC was to meet (footnote continued on next page.)

The Commission's approval of the proposed rule changes appears to be based on the assumption that it is "impossible" for NSCC's move to Phase II to be accomplished, in Commissioner Evans' words, all "at the same time." But there is no evidence in the record to support this assumption. Furthermore, the assumption is inconsistent with the Commission's own statement in the Consolidation Order at 43-44 (App. at 9):

14/ (continued)

the four conditions, the following interchange occurred between Chairman Williams and Congressman Eckhardt:

MR. WILLIAMS:

[T]he assumption has been made that the combination of [SCC, ASECC and NCC]...that the momentum and the desire would be that the integration occurred, that the four conditions be met and that economically those were desirable and would be achieved in a reasonable and would be achieved in a reasonable period of time and that all good faith and all efforts would be directed toward that end.

Now if the process is turned around and if the interim period or the non-compliance is being used as a haven, if you will, and as a protection, then it clearly violates what the Commission considered to be the objective.

MR. ECKHARDT:

Or as a twilight period while the proposed integrated system builds its regional operations to supplant its competition.

Transcript of Hearings before the Subcommittees on Oversight and Investigations and Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce, 95th Cong., 1st Sess., 270 (June 23, 1977).

It is thus clear that when and how satisfaction of the four conditions occurs will significantly affect competitive conditions in the clearing industry, and, therefore, compliance with the competitive objectives of the Act.

Following transfer to NSCC of the clearing agency operations of ASECC, NCC and SCC and their contributions of cash and assets, NSCC will operate the business of each transferor clearing agency as a separate NSCC Division, i.e., the ASECC Division, the NCC Division and the SCC Division. Each division will operate under substantially the same rules, procedures and agreements used by the division's predecessor clearing agency. Operation under the divisional structure, which NSCC has estimated would last approximately 120 days, is referred to as "Phase I" of the merger...During Phase I, SIAC will continue its current role as processor for ASECC and SCC. In addition, building in part on the work done already in preparing the technical portions of the application, SIAC will develop a plan to convert the ASECC-SCC and NCC systems into a single system combining desirable aspects of both. Operating rules and procedures for the combined system will be prepared by NSCC and SIAC and submitted to the Commission for review and approval before they could be implemented. Following Commission approval of the combined system's rules and procedures, NSCC and SIAC will begin to operate the combined system, thereby initiating "Phase II" of the merger plan.

The purpose of freezing NSCC's divisional structure and requiring the business of each of the predecessor clearing agencies to be continued in the successor divisions "under substantially the same rules, procedures and agreements" was to prevent NSCC from offering

services other than those offered presently by its operating divisions until each of the clearing corporations which must establish links with NSCC in order to provide the accounting and settlement component of one account settlement has, in the judgment of the Commission, completed or had an adequate opportunity to complete arrangements with NSCC necessary to enable it to provide services comparable to those which NSCC intends to provide.

Consolidation Order at 69-70 (App. at 15).

The Commission determined in the Consolidation Order that the achievement of a national clearing system as required by the Act, is to be accomplished by conditioning the commencement of Phase II of NSCC's operations on its satisfaction of the four conditions. This leaves open, however, the question of how close NSCC can, consistent with the Commission's determination, be permitted to get to Phase II without having satisfied the conditions. Obviously, the answer should depend in large part on whether Phase II can or cannot be accomplished "all at once." The rule changes represent significant steps toward Phase II. Cf Section II, infra. Therefore, the determinations of whether the rule changes are consistent with the requirements of [the Act], "Section 19(b), 15 U.S.C. §78s(b), and the extent to which they are "necessary or appropriate in furtherance of the purposes of [the Act]", Section 17A(b)(3)(I), turn on the manner in which the steps necessary to achieve Phase II must occur to assure achievement of a true national clearing system: "all happen at the same time", as Commissioner Evans "had sort of anticipated", or "piecemeal", as the Commission staff asserts.

Petitioners believe that a fair reading of the Consolidation Order makes clear that the Commission there required that the transition from Phase I to Phase II occur "all at once", and, therefore, that the Rules Order is inconsistent with the Consolidation Order Part II, infra.

However, regardless of the presence of such an inconsistency, the Commission in this proceeding clearly rested its decision to approve the NSCC rule changes on the conclusion that the transition to Phase II must proceed "piecemeal". There is no basis in record for that conclusion. Rather, all that is present is the bald assertion of a staff member that "everything can't be done at once".

Such bald assertions unsupported by evidence in the record cannot justify the Commission's Rules Order. Natural Resources Defense Council v. Securities and Exchange Commission, CCH Sec. L. Rep. ¶96,057, at p. 91,770 (D.D.C. 1977). The Commission's failure to explain why "everything can't be done at once" is similar to the Secretary of Labor's failure to provide an adequate basis for certain determinations in Industrial Department AFL-CIO v. Hodgson, 499 F.2d 467 (D.C. Cir. 1974). In that case, the Secretary had refused to impose different asbestos safety standards for different industries because such differentiation would lead to "impractical administration." Id. at 480. In reversing, the Court stated that the reason for that determination was "neither explained nor apparent" and therefore could not be affirmed. Id.

Based on the present record, there is no way to determine whether it is technologically impossible for NSCC to develop an overall plan of implementation that could "all happen at the same time", as suggested by Commissioner Evans (App. at 100), or whether that approach is simply less desirable for NSCC. As in the Hodgson case, the agency's deter-

mination may prove to be correct, but "there is no evidence to that effect in the record" and it is "not for the Court to guess at or supply justifications" for the Rules Order. Industrial Department AFL-CIO v. Hodgson, 499 F.2d at 481; Securities and Exchange Commission v. Chenery Corporation, 318 U.S. 80, 94 (1943).

By requiring that the premises for Commission action be supported by "substantial evidence", Section 25(a)(4), 15 U.S.C. §78y(a)(4), Congress sought to "mak[e] it absolutely clear that the reviewing court is not automatically to assume that the factual premises for SEC policy determinations are correct, but is to subject these premises to searching and careful inquiry". Report on S. 249 at 37. The Commission's acceptance of the staff's unsupported contention as to the need for proceeding "piecemeal" toward Phase II simply cannot withstand such "careful and searching" scrutiny.

Subsequent to the Rules Order the Commission published NSCC's plan for consolidating its three operating divisions (ASECC, NCC and SCC) and solicited public comment thereon (Release No. 34-13526 (May 10, 1977)). Petitioners, among others, submitted extensive letters pointing out numerous shortcomings and inadequacies in the plan and requesting the Commission to take appropriate action. The SEC staff advised counsel to BPS that this plan was not a filing by a clearing agency under section 19(b) of the Act, 15 U.S.C. §78(b). Petitioners were led to understand that the

Commission would not review and pass upon, either to approve or disapprove, the subject plan.

C. The Commission Failed Properly to Weigh the Anticompetitive Effects of the Rule Changes Against Their Necessity or Appropriateness Under the Act.

In carrying out its obligation to determine whether the proposed rule changes "impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]", Section 17A(b)(3)(I), 15 U.S.C. §78q-1(b)(3)(I), the Commission is obligated "to balance the perceived anti-competitive effects of a regulatory policy or decision (whether its own or that of a self-regulatory organization) against the purposes of the Exchange Act that are advanced thereby and the costs of doing so." Conference Report at 94. In this instance, however, the Commission neither identified the competitive burdens imposed by the rule changes under consideration, Part I.A, supra, nor did it properly evaluate the extent to which these rules were necessary or appropriate in furtherance of the achievement of a national clearing system, Part I.B, supra. As a consequence, the Commission failed properly to carry out the balancing process required under the Act.

Under the scheme of the Act, the Commission should have engaged in the following analysis in reviewing the NSCC's proposed rule changes:

- (1) Determine the nature and extent of the burdens on competition that would be imposed by approval of the proposed rule changes;
- (2) Determine the purposes of the Act that would be furthered by approval of the proposed rule changes that could not be satisfied by waiting to move into Phase II all at once;
- (3) Determine the costs, including regulatory costs, of achieving the identified purposes of the Act by approving the rule changes; and
- (4) Balance the competitive burdens and regulatory costs of the proposals against their benefits.

The Commission failed to perform properly any part of this analysis.

An indication of the seriousness of the Commission's disregard of its balancing responsibility under the Act is the following colloquy during the Commission's consideration of the proposed rule changes between Commissioner Evans and a member of the Commission staff:

COMMISSIONER EVANS:

Is there anything about this procedure or in doing this right at this time, as compared to doing the other things that need to be done in order to get to Phase II, that jeopardizes the ability of Bradford and their various subsidiaries or affiliates to compete any more than it would be if it were all done at once is the thing I'm trying to get at.

MR. NULAND:

Oh, I see.

COMMISSIONER EVANS:

Is this being done in a way that jeopardizes their ability to compete any more than it would if they did it all at once and went into Phase II at one time.

MR. NULAND:

Now that I don't know.

COMMISSIONER EVANS:

That's really what I'm asking. That is the only fair question I think I could ask you.

(App. at 114).

Petitioners agree with Commissioner Evans that part of the Commission's responsibility and thus one of the "fair questions" for its consideration is the anticompetitive impact on Petitioners of the approval of the proposed rule changes as opposed to that of moving to Phase II "all at one time." Because the staff "didn't know" the answer to that question -- and there is no indication in the record that the Commission otherwise knew -- it was impossible for the Commission properly to evaluate the rule changes under the Act.

Without an appreciation of the anticompetitive impact of the rules proposals on Bradford -- perhaps "the only real competition with NSCC in many instances" -- the Commission's approval of the rule changes was arbitrary, capricious, an abuse of discretion, and not in accordance with law.

In determining whether the Commission properly undertook the analysis required by the Act, this court should be guided by the

Supreme Court's admonition in National Labor Relations Board v. Brown, 380 U.S. 278, 291-92 (1965):

[R]eviewing courts are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute. Such review is always properly within the judicial province, and courts would abdicate their responsibility if they did not fully review such administrative decisions. Of course, due deference is to be rendered to agency determinations of fact, so long as there is substantial evidence to be found in the record as a whole. But where, as here, the review is...of a judgment as to the proper balance to be struck between conflicting interest, "[t]he deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia which results in unauthorized assumption by an agency of major policy decisions properly made by Congress." (Citation omitted; emphasis added.)

The Court's obligation not merely to rubber-stamp the Commission's decision herein is well established. E.g., Ethyl Corp. v. Environmental Protection Agency, 541 F.2d 1, 33-36, 176 U.S. App. D.C. 373 (D.C. Cir.) (en banc), cert. denied, 426 U.S. 941 (1976); Industrial Union AFL-CIO v. Hodgson, 499 F.2d 476, 474-76, 162 U.S. App. D.C. 331 (D.C. Cir. 1974); Greater Boston Television Corp. v. Federal Communications Commission, 444 F.2d 841, 850, 143 U.S. App. D.C. 383 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971). In Natural Resources Defense Council v. Securities and Exchange Commission, CCH Fed. Sec. L. Rep. ¶96,057 (D.D.C. 1977) the District Court for the District of Columbia reversed the Commission's decision not to require addi-

tional disclosure by registrants of environmental and equal opportunity information. The Court, while noting that agency determinations are entitled to deference, stated (CCH Fed. Sec. L. Rep. ¶96,056 at 91,764-765):

This is not to say, however, that we must rubber-stamp the agency decision as correct. To do so would render the appellate process a superfluous (although time-consuming) ritual. Rather, the reviewing court must assure itself that the agency decision was "based on a consideration of the relevant factors." Moreover, it must engage in a "substantial inquiry" into the facts, one that is "searching and careful."...

A court does not depart from its proper function when it undertakes a study of the record, hopefully perceptive, even as to the evidence on technical and specialized matters, for this enables the court to penetrate to the underlying decisions of the agency, to satisfy itself that the agency has exercised a reasoned discretion, with reasons that do not deviate from or ignore the ascertainable legislative intent. (Citation omitted.)

Simply because the Commission's proceedings may be characterized as "informal" (as opposed to "on the record") does not lessen the Commission's obligations under the Act to focus with particularity on the competitive implications of proposed regulatory actions or the Court's duty to review strictly the Commission's determinations and conclusions. Industrial Union Department AFL-CIO v. Hodgson, 499 F.2d 467, 162 U.S. App. D.C. 331 (D.C. Cir. 1974). Where the facts underlying the Commission's determinations, such as the necessity for proceeding "piecemeal" toward Phase II, are

susceptible of documentation in the usual sense, such findings must be made based on evidence in the record. Id. at 474-76. And "policy decisions," which may not be susceptible to the same type verification as factual questions, are nevertheless to be subjected to "exacting scrutiny" by the reviewing court. Id. at 475. As stated by this Court in Hodgson, id. at 475-76:

What [the Court is] entitled to at all times is a careful identification...of the reasons why [the agency] chose to follow one course of action rather than another. Where that choice purports to be based on the existence of certain determinable facts, the [agency] must, in form as well as substance, find those facts from evidence in the record.

An examination of the Rules Order and the record demonstrates that the Commission did not identify or appreciate the significant burdens on competition imposed by the proposed rule changes, did not properly evaluate the benefits to be achieved by these rules, and thus was unable, indeed made no attempt, to strike a proper balance between such competitive burdens and their necessity or appropriateness for the achievement of purposes of the Act. In reviewing the Rules Order, the Court is "required to assess the justification for the balance the Commission has struck between the preceived anticompetitive effects of the regulatory policy at issue and the purposes of the Exchange Act that would be advanced thereby and the costs of doing so." Conference Report at 100. Because the Commission has failed to strike such a reasonable balance, much less offer a credible justification for it, the Rules Order should be declared unlawful and set aside.

D. The Special Representative Rule is Contrary to the Act

The Act clearly contemplates that there will be competition between clearing agencies, Section 17A (a) (2), 15 USC Section 78q-1 (a) (2). Further, as part of the NCS, Congress found that clearing agencies should be linked together, Section 17A (a) (1) (D), 15 USC Section 78q-1 (a) (D).

To assure that there was competition among clearing agencies Congress prohibited clearing agencies from adopting rules imposing burdens on competition not necessary or appropriate in furtherance of the ACT's purposes, Section 17A (b) (3) (I) Section 78q-1 (b) (3) (I). Similarly, Congress directed the Commission in its rulemaking activities specifically to consider the impact of such rule on competition, Section 23 (a) (2), 15 USC Section 78W (a) (2). In fact, as part of its efforts to assure clearing agency competition, Congress went even further and prohibited the regulatory organizations for the various marketplaces, the national securities exchanges and registered securities associations, from limiting or conditioning participation by their members in any registered clearing agency, Section 11A (c) (5), 15 USC Section 78K-1 (c) (5). Congress clearly contemplated that there would be a NCS consisting of competing clearing agencies each of which would perform clearance and settlement service. Report on H.R. 4111 at 51.

Comparison, the process by which the parties confirm the transactions and its details, has historically been a function of clearance and settlement. Although, with the development of a more automated trading market, comparison could now be a function of the trading market. However, until the SEC orders such a shift in functions one effect of the Special Representative Rule will be to preclude clearing agencies that compete with SCC from performing trade comparison for trades between their participants and Special Representatives.

Under the Special Representative Rule, a Special Representative may submit to SCC trade data in "acceptable" securities between itself and a non-participant in NSCC if the non-participant in NSCC if the non-participant is either a participant in another clearing agency interfacing with SCC or a Special Representative guarantees these trades of the non-participant.

The submitted trade data must call for the delivery by one party and receipt by the other of "acceptable" securities, which data need not have been compared either by SCC or any other clearing agency.

NSCC's Form 19b-4A suggests that if the trade is in a security on SCC's list of "Cleared Securities" it may be com-

pared by SCC and processed through its CNS system (App. at 65). If the trade is between two brokers who either are themselves Clearing members or have Special Representatives acting for them, the trade will be submitted to SCC for comparison. If the trade is between a Special Representative and a non-SCC participant which participates in a clearing agency with an interface with SCC, the rule change makes no provision for comparison. Rather the rule change appears to establish a system for delivery of "acceptable" securities against receipt of the proceeds of same. The comparison function is eliminated.

The non SCC participant's clearing agency will be notified of its participant's deliver or receive obligation by SCC, and pursuant to its arrangement with its participant, as called for by the rule change, will act accordingly. If the terms of SCC's instructions are not correct or if, in fact, there was no trade, that is a matter to be resolved between the non-SCC participants and the Special Representative. The other clearing agency traditional function of effecting comparison on behalf of its participants so that only trades, the terms of which the parties have agreed to, can proceed forward for clearance and settlement is omitted.

II. The Commission's Approval of the Rules Changes Prior to Satisfaction of the Conditions to its Consolidation Order and Elimination of the Tying Rules Was Arbitrary and Capricious and not in Accordance with the Act.

As Petitioners have argued above, it was incumbent upon the Commission in this proceeding to determine the purposes of the Act that would be furthered by approval of the proposed rule changes and the nature and extent of the burdens on competition that would be imposed by such approval. This is not a mere formality, but a Congressionally mandated policy directive not to be ignored by the Commission.

In making these determinations, the Commission was required to consider not only the requirements of the Act, but also its own prior regulatory decision that approval of the NSCC consolidation would be consistent with the Act only if NSCC satisfied certain conditions prior to beginning consolidated operations. In the instant proceeding, however, the Commission failed fully to consider, and proceeded without knowledge of, the impact its approval would have on potential competitors of NSCC who were supposed to be "protected" by those conditions.

Ignoring this important question clearly constitutes arbitrary and capricious agency action, Natural Resources Defense Council v. Securities and Exchange Commission, CCH Fed. Sec. L. Rep. ¶96,057 (D.D.C. 1977); see also Udall v. Federal Power Commission, 387 U.S. 428 (1967), it calls into doubt not only the Commission's action in this case but also the effectiveness of its program to ensure that competition will be fostered in a national clearance and settlement system.

In conditionally approving the NSCC merger, the Commission had previously determined that the imposition of four conditions was necessary in order to satisfy the competitive requirements of the Act. To maintain fair competition and to ensure that no unnecessary or inappropriate burden was imposed on competition, the Commission sought to preclude NSCC from operating its separate divisions as an integrated enterprise, e.g., combining the ASECC and SCC clearing functions, and from offering new services until the conditions had been fulfilled.

The NSCC consolidation had been approved over the objection of the Antitrust Division of the Department of Justice and other clearing agencies that the consolidation was grossly anticompetitive and not necessary or appropriate in furtherance of the purposes of the Act. The Commission's response was to approve the consolidation, but only subject to the conditions.

When it approved the NSCC consolidation, the Commission found that "the conditions imposed by [its consolidation] order [would] counter the negative consequences" which might result from allowing the immediate consolidation of the various functions performed by the predecessor entities. Consolidation Order at 68 (App. at 15). These conditions were meant to provide all potential competitors, including Petitioners, the opportunity to offer services similar to those NSCC would offer in an integrated system and to ensure that NSCC did not make "inappropriate use of its pivotal position" during the interim period before implementation of Phase II.

(See pages 18 -22 , supra.) More specifically, the Commission stated that:

As a result of the Free Interface Condition, NSCC [would] not be able to offer services other than those offered presently by its operating divisions until each of the clearing corporations which must establish links with NSCC in order to provide the accounting and settlement component of one account processing has, in the judgment of the Commission, completed or had an adequate opportunity to complete arrangements with NSCC necessary to enable it to provide services comparable to those which NSCC intends to provide.

Consolidation Order at 69-70 (App. at 15). In addition, "the requirement that Phase II operations not be initiated until the conditions are satisfied [was] intended [by the Commission] to ensure that no irreversible steps are taken before the installation of mechanisms which the Commission believe[d] [would] prevent Phase II operations from imposing unnecessary or inappropriate burdens on competition." (Id. at 81, App. at 17).

Thus, it is apparent that the Commission believed that the NSCC consolidation (creating a single entity with an 85% share of the market) would be consistent with the Act only if the conditions were fulfilled, and that allowing NSCC to combine operations or offer new services prior to satisfaction of those conditions would be inconsistent with the requirements of the Act.

In contravention of the Consolidation Order, the Commission in the instant case has allowed NSCC both to offer new services and to integrate certain other prior to satisfaction of the

conditions. The Bond Rule is designed to combine all listed bond operations in "a single NSCC division rather than two or three NSCC divisions." Form 19b-4A, File No. SR-NSCC-77-1 (Appendix at 37). This is in direct contravention of the Commission's assurance that prior to the satisfaction of the four conditions the three NSCC divisions would "operate under substantially the same rules, procedures and agreements used by the division's predecessor clearing agency." Consolidation Order at 43 (App. at 9). The Special Representative Rule significantly expands the services offered by NSCC toward full one account processing despite the fact that competing clearing corporations are unable to offer comparable services. This again is in direct contravention of the Commission's assurances in the Consolidation Order at 79-80 (App. at 17). For the Commission to act in this matter and to withdraw from Petitioners such benefit as they might have derived from the requirement that the conditions be satisfied before integration occurred and new services were offered is arbitrary and capricious and requires reversal of its order. Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971).

According to the Commission, even though Petitioners do not now offer clearance services on a CNS basis, it "did not contemplate that [they] would be denied the benefits of an interface with NSCC. Brief of SEC in BNCC and BSPS v. SEC, No. 77-1199 (D.C. Cir.) at 35.

For Petitioners to derive any benefit from the Free Interface Condition the "tying" rules must be eliminated. Petitioners must then have sufficient time to develop the systems necessary to attract customers and to interface with NSCC prior to the commencement of Phase II. Given NSCC's already substantial "head start" and its enormous market share there is little doubt that once Phase II begins, competition from new entrants is highly unlikely to develop. If Petitioners undertake development of the necessary systems, but are not ready to offer services competitive with those offered by NSCC at the same time NSCC begins Phase II operations, their efforts will have been completely wasted. Approval of the proposed rule changes, while the "tying" rules remain in effect, makes it virtually certain that Petitioners will never be in a position to take advantage of whatever benefit might be afforded by the Free Interface Condition.

Putting aside the absolute necessity that the "tying" rules be eliminated before the Rule changes at issue here are approved, crucial to Petitioners' planning and decision-making is a sound basis for determining how much time remains until Phase II begins and what will transpire before that occurs. Thus, prior to the Rules Order Petitioners "anticipated [as did Commissioner Evans] that NSCC would come in with an overall plan as to how they would get us to Phase II, and it would...happen at the same time." (App. at 106). Now, however, the Commission is not only allowing NSCC to proceed piecemeal without a showing that proceeding in that way is necessary or appropriate to the Act, Point I.B, supra, but is also allowing NSCC to integrate its

operations and to offer new services at a time when the tying rules preclude Petitioners and others from offering competing services.

The sole basis that the Commission puts forth to justify approval of the NSCC rule changes in apparent contravention of the Consolidation Order is the unsupported assertion that "everything can't be done at once." (App. at 107). Even if this were the case, there would be no justification for allowing such piecemeal development without requiring NSCC to inform Petitioners and the Commission as to where and how each piece fits into an overall implementation plan.^{15/} Indeed, Petitioners do not understand how the Commission was able to conclude that these rule changes would "implement" the Free Interface Condition without having had such an overall plan before it. Here, as in Industrial Department AFL-CIO v. Hodgson, the record, "examined closely in relation to the purposes of the Act, leaves nagging questions -- even for the inexperienced observer -- as to the reasons and rationale for" the Commission's conclusions. 499 F.2d at 488.

The Commission's approval of these rules, in the absence of a clear and reasonable justification for the departure from the position it announced in the Consolidation Order and while the NYSE and Amex tying rules are still in effect, is arbitrary and capricious and not in accordance with the legislative mandate that competitive opportunities be fostered rather than reduced, National Resources Defense Council v. Securities

^{15/} The NSCC conversion plan as published by the Commission, some 19 days after the Rules Order, shows that the conversion plan does not contain such information and only gives a vague idea as to when various event could occur. Sec. Rel. No. 13526 (May 10, 1977), 42 Fed. Reg. 25568 (May 18, 1977).

and Exchange Commission, CCH Fed. Sec. L. Rep. ¶96,057 (D.D.C. 1977). The Commission's approval of the rules changes, therefore, should be set aside.

CONCLUSION

Under the Act, the Commission, before it entered its Rules Order, was required to determine the anticompetitive consequences of the proposed rule changes and to balance those consequences against the benefits that might derive from its approval. As shown above, the Commission failed to fulfill that duty. Moreover, the Commission failed to follow its Consolidation Order which precluded NSCC from integrating its operations and offering new services prior to satisfying certain conditions to that Order. The effect of the Rules Order is to allow NSCC to gain a significant competitive advantage in contravention of the Consolidation Order and the Act.

The Commission's conclusion that the Rules Order fosters competition, as mandated by Congress, reminds one of the Queen of Hearts in Alice in Wonderland. Because the Queen says something, one is supposed to believe it -- even if the statement is erroneous.

This aura of the "Queen" was seriously questioned by Representative John E. Moss in a June 29, 1977 letter to Chairman Harold Williams of the SEC, as quoted from in an editorial in Barrons, September 12, 1977, p. 7:

"I found the testimony concerning the national clearance and settlement system somewhat bizarre. We were told that an objective in creating a clearing organization with an 85% market share was to 'preserve, introduce and foster additional competition between clearing agencies. . . .' In my long experience as a state and federal legislator, I can remember no other instance where competition was fostered by creating a monopoly.

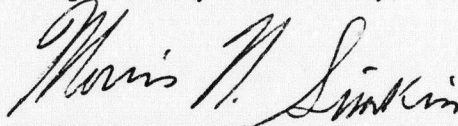
"We were told that approval of a clearing agency with an 85% market share would preserve 'the only possibility for the regional clearing organizations to maintain a competitive position.' Yet the regional clearing organizations argued strenuously at your hearings last year that the creation of this giant would place their continued existence in great doubt, and their testimony before our Committee indicated that their worst fears are being realized.

"We were told that the approval of the NSCC application was the most feasible and expeditious method of leading to the establishment of a national clearing and settlement system. . . . 'But a review of your own hearing record indicates that a number of other options are open to the Commission which are much more in tune with the Congressional charge of fostering competition and competing service entities.'"

Simply because the Commission states that the Rules Order will enhance competition does not make it so. Quite the contrary is so because the Commission failed to understand and evaluate properly the anticompetitive impact of the Rules Order in relation to the Act.

For the foregoing reasons, Petitioners respectfully request this Court to reverse the Commission's Rules Order.

Respectfully submitted,



MORRIS N. SIMKIN
1700 Broadway, 20th Floor
New York, New York 10019

Attorney for Petitioners

APPENDIX I

Section 3(a)(23) of the Securities Exchange Act of 1934,
15 U.S.C. §78c(a)(23):

(23) (A) The term "clearing agency" means any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.

(B) The term "clearing agency" does not include (i) any Federal Reserve bank, Federal home loan bank, or Federal land bank; (ii) any national securities exchange or registered securities association solely by reason of its providing facilities for comparison of data respecting the terms of settlement of securities transactions effected on

such exchange or by means of any electronic system operated or controlled by such association; (iii) any bank, broker, dealer, association, or cooperative bank would be deemed to be a clearing agency solely by reason of functions performed by such institution as part of customary banking, brokerage, dealing, association, or cooperative banking activities, or solely by reason of acting on behalf of a clearing agency or a participant therein in connection with the furnishing by the clearing agency of services to its participants or the uses of services of the clearing agency by its participant, unless the Commission, by rule, otherwise provides as necessary or appropriate to assure the prompt and accurate clearance and settlement of securities transactions or to prevent evasion of this chapter; (iv) any life insurance company, its registered separate accounts, or a subsidiary of such insurance company solely by reason of functions commonly performed by such entities in connection with variable life policies issued by such insurance company or in its separate accounts; (v) any registered open-end investment company or unit investment trust solely by reason of functions commonly performed by it in connection with shares in such registered open-end investment company or unit investment trust, or (vi) any person solely by reason of its performing functions described in paragraph (25)(E) of this subsection.

Section 31(b) of the Securities Acts Amendments of 1975,
15 U.S.C. §78f(nt):

(b) If it appears to the Commission at any time within one year of the effective date of any amendment made by this Act to the Securities Exchange Act of 1934 that the organization or rules of any national securities exchange or registered securities association registered with the Commission on the date of enactment of this Act do not comply with such Act as amended, the Commission shall so notify such exchange or association in writing, specifying the respects in which the exchange or association is not in compliance with such Act. On and after the one hundred eightieth day following the date of receipt of such notice by a national securities exchange or registered securities association, the Commission, without regard to the provisions of section 19(h) of the Securities Exchange Act of 1934, as amended by this Act, is authorized by order, to suspend the registration of any such exchange or association, if the Commission finds, after notice and opportunity for hearing, that the organization or rules of such exchange or association do not comply with such Act. Any such suspension or limitation shall continue in effect until the Commission, by order, declares that such exchange or association is in compliance with such requirements.

Section 11A(c) (5) of the Securities Exchange Act of 1934,
15 U.S.C. §78k-1(c) (5):

(5) No national securities exchange or registered securities association may limit or condition the participation of any member in any registered clearing agency.

Section 17A(a) and (b) (1)-(3) of the Securities Exchange Act of 1934, 15 U.S.C. §78q-1(a) and (b) (1)-(3):

§78q--1

(a) (1) The Congress finds that --

(A) The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(B) Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.

(C) New data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement.

(D) The linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will re-

duce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(2) The Commission is directed, therefore, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents, to use its authority under this chapter to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities (other than exempted securities) in accordance with the findings and to carry out the objectives set forth in paragraph (1) of this subsection. The Commission shall use its authority under this chapter to assure equal regulation under this chapter of registered clearing agencies and registered transfer agents.

(b) (1) Except as otherwise provided in this section, it shall be unlawful for any clearing agency, unless registered in accordance with this subsection, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to any security (other than an exempted security). The Commission, by rule or order, upon its own motion or upon application, may conditionally or unconditionally exempt any clearing agency or security or any class of clearing agencies or securities from any provisions of this section or the rules or regula-

tions thereunder if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of this section, including the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds. A clearing agency or transfer agent shall not perform the functions of both a clearing agency and a transfer agent unless such clearing agency or transfer agent is registered in accordance with this subsection and subsection (c) of this section.

(2) A clearing agency may be registered under the terms and conditions hereinafter provided in this subsection and in accordance with the provisions of section 78s(a) of this title, by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the clearing agency and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the prompt and accurate clearance and settlement of securities transactions.

(3) A clearing system shall not be registered unless the Commission determines that --

(a) Such clearing agency is so organized and has the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions for which it is responsible, to safeguard securities and funds in its custody or control or for

which it is responsible, to comply with the provisions of this chapter and the rules and regulations thereunder, to enforce (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) compliance by its participants with the rules of the clearing agency, and to carry out the purposes of this section.

(B) Subject to the provisions of paragraph (4) of this subsection, the rules of the clearing agency provide that any (i) registered broker or dealer, (ii) other registered clearing agency, (iii) registered investment company, (iv) bank, (v) insurance company, or (vi) other person or class of persons as the Commission, by rule, may from time to time designate as appropriate to the development of a national system for the prompt and accurate clearance and settlement of securities transactions may become a participant in such clearing agency.

(C) The rules of the clearing agency assure a fair representation of its shareholders (or members) and participants in the selection of its directors and administration of its affairs. (The Commission may determine that the representation of participants is fair if they are afforded a reasonable opportunity to acquire voting stock of the clearing agency, directly or indirectly, in reasonable proportion to their use of such clearing agency.)

(D) The rules of the clearing agency provide for the equitable allocation of reasonable dues, fees, and other charges among its participants.

(E) The rules of the clearing agency do not impose any schedule of prices, or fix rates or other fees, for services rendered by its participants.

(F) The rules of the clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this section or the administration of the clearing agency.

(G) The rules of the clearing agency provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its parti-

cipants shall be appropriately disciplined for violation of any provision of the rules of the clearing agency by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, or any other fitting sanction.

(H) The rules of the clearing agency are in accordance with the provisions of paragraph (5) of this subsection, and, in general, provide a fair procedure with respect to the disciplining of participants, the denial of participation to any person seeking participation therein, and the prohibition or limitation by the clearing agency of any person with respect to access to services offered by the clearing agency.

(I) The rules of the clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

Sections 19(b)(1) and (2) of the Securities Exchange Act of 1934, 15 U.S.C. §78s(b)(1)-(2):

§78s(b)(1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change,

publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) Within thirty-five days of the date of publication of notice of the filing of a proposed rule change in accordance with paragraph (1) of this subsection or within such longer period as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall --

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved. Such proceedings shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within one hundred eighty days of the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to sixty days if it finds good cause for such extension.

sion and publishes its reasons for so finding or for such longer period as to which the self-regulatory organization consents.

The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this chapter and the rules and regulations thereunder applicable to such organization. The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the thirtieth day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

Section 23(a)(3) of the Securities Exchange Act of 1934,
15 U.S.C. §78w(a)(2):

(a)(2) The Commission, in making rules and regulations pursuant to any provisions of this chapter, shall consider among other matters the impact any such rule or regulation would have on competition. The Commission shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter. The Commission shall include in the statement of basis and purpose incorporated in any rule or regulation adopted under this chapter, the reasons for the Commission's determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of this chapter.

Section 25(a) (1)-(4) of the Securities Exchange Act of 1934,
15 U.S.C. §78y(a) (1)-(4):

§78y(a) (1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

(2) A copy of the petition shall be transmitted forthwith by the clerk of the court to a member of the Commission or an officer designated by the Commission for that purpose. Thereupon the Commission shall file in the court the record on which the order complained of is entered, as provided in section 2112 of Title 28 and the Federal Rules of Appellate Procedure.

(3) On the filing of the petition, the court has jurisdiction, which becomes exclusive on the filing of the record, to affirm or modify and enforce or to set aside the order in whole or in part.

(4) The findings of the Commission as to the facts, if supported by substantial evidence are conclusive.

Securities and Exchange Commission Rule 19b-4, 17 C.F.R.

§240.19b-4 (1976):

§240.19b-4

(a) The term "proposed rule change" means any proposed

rule or any proposed change in, addition to, or deletion from the rules of a self-regulatory organization. A stated policy, practice, or interpretation of a self-regulatory organization shall be deemed to be a rule of the self-regulatory organization if (1) action thereon by the members or by the board of directors, or similar governing body of such self-regulatory organization is required under its constitution, articles of incorporation, by-laws, rules, or instruments corresponding thereto, (2) a self-regulatory organization affects or is required, pursuant to its constitution, articles of incorporation, by-laws, rules, or instruments corresponding thereto, to treat it as a rule change hereunder, (3) it represents a change in, addition to, or deletion from a stated policy, practice or interpretation which the self-regulatory organization previously treated as a proposed rule change or (4) it requires a determination, or affects a prior determination, pursuant to Rules 8c-1(g) or 15c2-1(g).

(b) The term "stated policies, practices and interpretations" includes any material aspect of the operation of the facilities of the self-regulatory organization or any statement made generally available to the membership of, or all participants in, or persons having or seeking access (including, in the case of national securities exchanges or registered securities associations, through a member) to facilities of, a self-regulatory organization, or to a group or category of such persons, establishing or

changing any standards or guidelines with respect to (1) the rights or obligations of such persons or in the case of national securities exchanges or registered securities associations, persons associated with such persons or (2) the application or interpretation of an existing rule.

(c) Filings with respect to proposed rule changes by a self-regulatory organization shall be made on Form 19b-4A. Notice on Form 19b-4B as to a stated policy, practice or interpretation which the self-regulatory organization believes may be characterized as not constituting a rule pursuant to paragraph (a) of this section shall be mailed first class, postage prepaid, to the Commission, not later than the date on which it is first made generally available.

(d) A proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act if designated by the self-regulatory organization as (1) constituting a stated policy, practice or interpretation with respect to the meaning, administration, or enforcement of an existing rule, (2) establishing or changing a due, fee, or other charge, or (3) concerned solely with the administration of the self-regulatory organization.

(e) After instituting proceedings to determine whether a proposed rule change should be disapproved, the Commission will afford the self-regulatory organization and interested persons an opportunity to submit additional written data, views and arguments and, in the discretion of the Commission, an opportunity to make oral presentations.

(f) Notice of orders issued pursuant to Section 19(b) of the Act will be given by prompt publication thereof, together with a statement of written reasons therefor.

(g) On or prior to April 1, 1976, each national securities exchange and securities association registered with the Commission on June 4, 1975, shall file with the Commission the information required by items 3, 4, 5 and 6 of Form 19b-4A with respect to each of its rules in effect on June 4, 1975, and on the date of filing.

(h) Self-regulatory organizations shall retain at their principal place of business a file, available to interested persons for public inspection and copying, of all filings made pursuant to this rule and all correspondence received by such self-regulatory organization with respect to any such filing.

